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IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-1568

DISTRICT OF COLUMBIA,
Petitioner,

v.

RICHARD A. BISHOP, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the District of Columbia Court of Appeals

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BRIEF FOR RESPONDENT KLEIBOEMER IN OPPOSITION

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BRIEF FOR RESPONDENT KLEIBOEMER IN OPPOSITION

Respondent Axel-Felix Kleiboemer, individually, and on behalf of the taxpayer class, respectfully requests that this Court deny the petition for a writ of certiorari seeking review of the en banc judgment of the District of Columbia Court of Appeals.

QUESTION PRESENTED

Whether Section 605 of the District of Columbia Revenue Act of 1975 which imposes a tax measured by

net income on nonresident professionals and nonresident owners of personal service businesses is violative of Section 602(a)(5) of the District of Columbia Self-Government and Governmental Reorganization Act which prohibits the District of Columbia City Council from imposing any tax on the personal income of nonresidents.

STATEMENT

By its petition, the District of Columbia seeks to have this Court review an en banc judgment of the District of Columbia Court of Appeals construing a local tax statute. In a 9-1 opinion issued February 12, 1980, following en banc rehearing at the District's request, the Court of Appeals affirmed an earlier holding by a three-judge division of the Court [1] that Section 605 of the District of Columbia Revenue Act of 1975 [2] —which repealed the exemption from taxation of professionals and owners of unincorporated personal service businesses under the District of Columbia unincorporated business tax [3]—imposed a tax on the personal

[1] *Bishop* v. *District of Columbia*, D.C. App., 401 A.2d 955 (1979).

[2] The District of Columbia Revenue Act of 1975 was enacted on October 21, 1975, as D.C. Law No. 1-23.

[3] District of Columbia Income and Franchise Tax Act of 1947, Pub. L. 80-195, 61 Stat. 328 *et seq.*, D.C. Code, 1973, § 47-1551 *et seq.* By its terms the 1947 Act imposed an "income tax" on the net income of District residents and a "franchise tax" measured by District source net income on the income of corporations and unincorporated businesses conducted in the District. Congress specifically exempted, however, two categories of unincorporated businesses from the tax: (1) those which "by law, customs or ethics cannot be incorporated" (professionals); and (2) those "in which more than 80 per centum of the gross income is derived from • • • personal services • • • and in which capital is not a material-income producing factor." 61 Stat. 345-346, D.C. Code, 1973, § 47-1574 ("professional exemption").

income of nonresidents in violation of the Congressional limitation on the taxing authority of the District of Columbia City Council set forth in § 602(a)(5) of the Home Rule Act.[4]

The applicable provision of the Home Rule Act states that "[t]he Council shall have no authority to * * * (5) impose any tax on the whole or any portion of the personal income, either directly or at the source thereof, of any individual not a resident of the District * * * *" D.C. Code § 1-147(a)(5) (Supp. V, 1978).

In March 1975 the District of Columbia City Council Finance and Revenue Committee noticed hearings on the Mayor's Fiscal 1976 Budget and solicited comments. The announcement provided notice to the affected taxpayers of a proposed gross receipts tax on all local businesses. The Mayor's Budget contained no proposal for the removal of the long-standing professional exemption from the 1947 District of Columbia unincorporated business tax.[5] Following the hearings, the Committee issued its report, recommending adoption of the Mayor's gross receipts tax proposal and further recommending retention of the 1947 professional exemption.[6] Shortly thereafter, retailers who opposed the gross receipts measure urged the City Council to remove the professional exemption.[7] Less than

[4] District of Columbia Self-Government and Governmental Reorganization Act, Pub. L. 93-198, 87 Stat. 774 (1973), codified at D.C. Code §§ 1-121 to -171 (Supp. V, 1978) ("Home Rule Act").

[5] Hearings on the District of Columbia Revenue Act of 1975 before the Senate Committee on the District of Columbia, 94th Cong., 1st Sess., Part I, 128-137, 331, 356-364.

[6] *Id.* at 301-302, 331.

[7] *Id.* at 131.

forty days later, with no further notice or public hearings,[8] the City Council passed the tax at issue.[9]

On December 12, 1975, before the first payment of the tax was due, suit was filed in the Superior Court of the District of Columbia contesting the legality of the tax and seeking injunctive relief. After a full record was developed on the merits, the case was dismissed because of the District's anti-tax injunction statute. D.C. Code, 1973, § 47-2410. Prior to dismissal, respondents Kleiboemer and Bishop initiated separate refund actions in the Superior Court alleging grounds of illegality substantially identical to those set forth in the injunctive suit.[10]

[8] *Id.* at 131-132.

[9] The tax is determined by calculating the net income of the unincorporated business, allowing for a deduction of all ordinary and necessary business expenses. From the net income is deducted a "salary allowance" of 70% of the net income and a $2500 exemption. The tax is then imposed on the balance—30% of net income less the $2500 exemption—at a present rate of 9.9% (Pet. 32a-33a at n. 18).

Resident owners of unincorporated businesses have that portion of their income which has been taxed under the unincorporated business tax, *i.e.*, approximately 30%, *excluded* from their gross income for purposes of the District of Columbia individual income tax. D.C. Code, 1973, § 47-1557a(a)(10). No such exclusion is available to nonresidents because they pay individual income tax to their states of residence and not to the District.

Because of this exclusion, hypothetical partners in a two-man law firm, one a resident of the District, the other a resident of Virginia, dividing $100,000 firm net income equally, bear the burden of the tax unequally. The nonresident's share of the unincorporated business tax is $1,361.25, which he must pay *in addition* to his Virginia income tax. The D.C. resident also pays a $1,361.25 share of the new tax, but because of the differential in the 9.9% rate for the new tax and 11% rate for the personal income tax, his individual income tax is *reduced* by $1,512.50, an *actual net reduction* of $151.25 in total District taxes based on income.

The trial judge initially denied respondents' claims. Thereafter, he filed a supplemental opinion holding the tax unconstitutional in part because it imposed the tax unequally on calendar-year and fiscal-year taxpayers. The District was ordered to refund all taxes collected for the period prior to December 1, 1975. (The tax was formally adopted into law in October 1975, but made retroactive to January 1, 1975.) Respondents appealed that part of the judgment which rejected their overall attack on the legality of the tax, and the District cross-appealed the calendar-fiscal-year ruling.

The Court of Appeals division opinion issued on April 20, 1979, recognized that the issue is whether the City Council's action in repealing the professional exemption of the 1947 Act imposes "a tax on the personal income of nonresidents or whether the tax is levied on something other than income (*e.g.*, the privilege of doing business in the District)." (Pet. 22a.)

In a carefully crafted opinion the Court held that "the D.C. unincorporated business tax is an income tax." (Pet. 22a-30a.) The Court reasoned:

> The professional tax, by its very terms, is a tax on net income. D.C. Code 1973, § 47-1547a defines taxable income, for purposes of the tax on unincorporated businesses, as "the amount of *net income* derived from sources within the District . . . in excess of the exemption granted by section 47-

[10] The two refund suits were consolidated for trial. Respondent Kleiboemer's suit was certified as a class action on behalf of all nonresidents subject to the tax and who paid the tax, except for respondent Bishop (Pet. 20a).

1574c (emphasis added)." Net income is defined in D.C. Code 1973 and 1978 Supp., §§ 47-1557 to -1557b. (Pet. 31a.)

The en banc opinion of the Court of Appeals, issued February 12, 1980, affirms the division's statutory construction of the tax:

> The arguments advanced by the government in the en banc rehearing of this case do not persuade this court to disturb the division's holding in *Bishop* v. *District of Columbia*, D.C.App., 401 A. 2d 955 (1979), that Section 605 of the Revenue Act of 1975 was an impermissible exercise of the District of Columbia Council's authority under § 602(a)(5) of the Home Rule Act. (Pet. 2a.) (Footnotes omitted.)

This petition for a writ of certiorari followed.

REASONS FOR DENYING THE WRIT

This Court has made clear it will not review judgments of the District of Columbia Court of Appeals on matters of purely statutory interpretation of local law unless the case involves an "exceptional" situation where "egregious error has been committed." *Pernell* v. *Southall Realty*, 416 U.S. 363, 369 (1974), quoting from *Griffin* v. *United States*, 336 U.S. 704, 718 (1949), and *Fisher* v. *United States*, 328 U.S. 463, 476 (1946). This practice of deference to decisions of the District of Columbia Court of Appeals on matters of exclusively local concern was recently reaffirmed by this Court in *Whalen* v. *United States*, No. 78-5471, decided April 16, 1980, 48 U.S.L.W. 4406. Measured by this standard, the decision here presents no reason why this Court should exercise its extraordinary and discretionary jurisdiction. As we show, the case is

neither "exceptional" nor does it contain "egregious error."

I

The District argues (Pet. II, 9-14) that the plain meaning of § 602(a)(5) of the Home Rule Act and settled principles of statutory construction establish that the tax in question is a franchise tax and not an income tax." This argument simply disagrees with the holding of the Court of Appeals; it in no way demonstrates that the Court committed "egregious error" under *Pernell* and *Whalen*.

In ruling the tax invalid, the Court of Appeals applied long-standing principles of analysis of tax statutes articulated by this Court. The Court looked to the "nature and effect of [the] . . . tax, not its label" (Pet. 27a), citing *Dawson* v. *Kentucky Distilleries*, 255 U.S. 288, 292 (1921). Further, the Court recognized that while not controlling, the legislative designation of the character of the tax "is entitled to much weight" (Pet. 27a), citing *Flint* v. *Stone Tracy Co.*, 220 U.S. 107 (1910). Upon analysis of the substance of the City Council's removal of the 1947 exemption, the Court properly found that "the nature and effect" of the action was to impose a tax on personal income.[12]

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[11] This in our view is the District's principal argument; accordingly, we treat it first.

[12] Under *Dawson*, an examination of the "incidents" of the tax demonstrates that its essential character is a levy on income and not a tax for the privilege of doing business. As pointed out *supra* n. 9, the tax is measured solely by net taxable income. Although purporting to tax the unincorporated entity, the statute makes clear that the burden of the tax is to fall *personally* upon those individuals receiving income solely by virtue of the personal services they perform. D.C. Code, 1973, § 47-1574d. Moreover, the

Contrary to the District's petition at 10-13, the Court of Appeals did not ignore the argument that because of the specific reference in § 602(a)(5) of the Home Rule Act that the terms "individual" and "resident" were to be understood as defined in "the District of Columbia Income and Franchise Tax Act of 1947," Congress intended to incorporate into the section the "conceptual distinctions" between personal income and franchise taxes set forth in the 1947 Act. The reference, however, has to be considered in the context of the overall background of the 1947 Act and the enactment of § 602(a)(5).

As indicated *supra* n. 3, the 1947 unincorporated business tax was imposed solely on capital intensive unincorporated businesses, expressly excluding professionals and personal service businesses. Beginning in 1967 the District on numerous occasions sought Congressional authorization to impose a commuter tax on the personal income of nonresidents, including the nonresident income exempted from the 1947 unincorporated business tax. Congress repeatedly rejected these proposals, primarily because the tax mechanism by which neighboring states allow residents a direct credit against their state income taxes would place the burden of a District commuter tax on all residents of Maryland and Virginia and not only on those who worked in the District. *See, e.g.*, District of Columbia Appro-

resident's share of the income of the unincorporated business subject to the tax is excluded from his gross income, and consequently is *excluded* from taxation under the District's individual income tax. If indeed, as the District contends, the tax were a true "franchise" tax for the privilege of deriving income from the conduct of an unincorporated business in the District, it would be applied equally to all who conduct such an enterprise regardless of the individual's residence.

priations: Hearings before the House Subcommittee on Appropriations, 92nd Cong., 1st Sess., Part I, 18 (1971). (Statement of Senator Eagleton.)

The professional exemption under the 1947 Act was considered by Congress in 1971 when it passed the District of Columbia Professional Corporation Act, Pub. L. 92-180, 85 Stat. 576, which gave professionals practicing in the District of Columbia the right to incorporate. Because one basis for exclusion from taxation under the 1947 Act was that professionals "by law, customs or ethics [could not] be incorporated," the District argued to Congress that if professionals were allowed corporate status, it logically would follow that the 1947 exemption should be removed. Congress refused to do so because such removal would impose a "commuter" tax on "one group of taxpayers." [13] And, as the Court of Appeals documented, there is no doubt that Congress intended to prohibit a "commuter" tax (as well as any tax "which is based on a percentage of income") in barring the City Council from imposing any tax directly or indirectly on the personal income of nonresidents. (Pet. 3a-4a, 24a-25a.)

Considering the broad prohibitive language of § 602(a)(5) and the unambiguous intent of Congress in its enactment, together with Congress' 1971 equation of removal of the 1947 exemption to a "commuter" tax, the Court of Appeals correctly rejected the District's "antecedent enactment" argument.[14]

[13] H.R. Rep. No. 92-508, 92nd Cong., 1st Sess. 4. Indeed, Congress amended the 1947 Act to make clear the exemption was being maintained even though professionals could incorporate. 85 Stat. 582.

[14] The Court of Appeals also correctly rejected the District's argument (Pet. 11-12) that Congress' failure in 1975 to exercise

Finally, the Court of Appeals decision does not, as the District argues (Pet. 14), preclude the District from imposing any franchise tax on nonresident professionals who operate their businesses within the District's borders. As the Court emphasized, the opinion holds "only that the District of Columbia cannot tax the net personal income of nonresidents." (Pet. 33a.) Any "inequities" or "inconsistencies" flowing from the District's inability to tax net personal income of nonresidents are fundamentally questions of tax policy. It is the Congress—and not this Court—to which the District of Columbia must turn for consideration.

In sum, the District of Columbia Court of Appeals division and en banc opinions engaged in a careful and thoughtful analysis of the tax statute in question and in ruling it unlawful, reached a conclusion that is defensible and free from "egregious error."

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its right under D.C. Code § 1-147(c) (Supp. V, 1978) to disapprove the City Council's removal of the 1947 exemption is strong evidence that the Council did not exceed its authority under the 1973 Home Rule Act. First, as this Court has held, in interpreting a statute, mere inaction by a subsequent Congress is ambiguous at best and "affords the most dubious foundation for drawing positive inferences." *United States* v. *Price*, 361 U.S. 304, 310-311 (1960). Second, a disapproval resolution was voted down in the House District of Columbia Committee and thus neither the House nor the Senate actually considered the measure. Moreover, the District's Congressional supporters recognized that the tax presented a "close legal question," one which should be resolved by a "court of competent jurisdiction." Hearings on the District of Columbia Revenue Act of 1975 before the Subcommittee on Fiscal Affairs of the House Committee on the District of Columbia, 94th Cong., 1st Sess. 180. (Statement of Congressman Dellums.)

II

None of the sundry arguments advanced by the District at pages 6-9 of its petition individually or collectively warrant certiorari in this case.

The decision does not, as the District argues, "reimpose" on Congress legislative functions that Congress delegated to the District. To the contrary, the decision holds that the action of the City Council in enacting this tax was *beyond* the authority delegated and thus unlawful. The decision does nothing more than reserve to Congress that which Congress expressly sought to reserve in its limited delegation of taxing authority to the Council.

The District complains that the Court of Appeals decision creates a "gaping hole" in the local franchise tax structure and generates an inequitable distribution of tax. But, by invalidating the tax, the decision simply restored the tax to the status which Congress itself created in 1947 and which Congress continued to maintain up until the City Council's action. Simply put, the so-called "gaping hole" is one which Congress—and not the Court—created on the basis of various reasons of tax policy properly within its ultimate domain.

Obviously, as the District stresses, the invalidated taxes are substantial and important to the District's general fiscal stability. Under *Pernell* and *Whalen*, however, this, standing alone, does not provide any basis for the Court to exercise its certiorari jurisdiction in what is a strictly local matter.[15]

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[15] The District (Pet. 6) relies on *Alaska* v. *Arctic Maid*, 366 U.S. 199 (1961), and *Territory of Alaska* v. *American Can Co.*, 358 U.S. 224 (1959), to support its claim that a matter of "fiscal importance" is sufficient to warrant certiorari review. Such reli-

Finally, the decision of the Court of Appeals involves no issue of national or federal significance.[16] The District argues (Pet. 8-9) that because the tax is imposed on professionals throughout the nation who practice in the District, the case extends beyond the

ance is misplaced. *Arctic Maid* involved a federal court of appeals decision that the tax at issue was constitutionally forbidden by the commerce clause. *American Can* involved tax liability of individuals under a territorial tax which the Ninth Circuit ruled did not survive repeal of the tax. This Court granted certiorari in 1958 *before* Alaska became a state. Thus, unlike the case here, *American Can* did not involve a ruling by the "highest court of a State" for purposes of 28 U.S.C. 1257(3). Moreover, *American Can* must be viewed in the context of this Court's express limitations in *Pernell* and *Whalen* that review of District of Columbia Court of Appeals decisions is appropriate *only* where there is *egregious error*, which is surely not the case here.

[16] Unlike the cases cited by the District (Pet. 6), the decision here is not enmeshed with any constitutional issues, nor does it affect in any way federal revenues or other federal interests. Compare *District of Columbia* v. *Thompson Co.*, 346 U.S. 100 (1953) [whether under Article I, section 8, clause 17 of the Constitution Congress could delegate to the District the power to enact laws forbidding racial discrimination by local restaurant operators]; *Shuttle Corp.* v. *Transit Comm'n*, 393 U.S. 186 (1968) [conflict between local transit commission and exclusive power of Secretary of Interior over the federal Mall]; *District of Columbia* v. *Murphy*, 314 U.S. 441 (1941), and *District of Columbia* v. *Pace*, 320 U.S. 698 (1944) [impact of local tax laws on persons residing in the District because of their federal employment]; *Commissioner* v. *Standard Life & Acc. Ins. Co.*, 433 U.S. 148 (1977) [split in circuit courts of appeals concerning treatment of federal taxing laws].

Respondents argued below that the tax unconstitutionally discriminated between residents and nonresidents. Also, as indicated, the trial judge ruled the tax unconstitutional in part. But, in view of its holding, the Court of Appeals did not reach these issues. (Pet. 33a.)

"shores of the Potomac." [17] This substantially misconstrues the operation of the tax. The tax is imposed only on the *local source* revenue of professionals and others, *irrespective* of their residency or other bases of operation. Further, because the decision invalidated the tax, no taxpayer outside the District—or within—will pay the challenged tax if the decision stands.

Similarly, the "interjurisdictional" conflict (Pet. 9) between the decisions of the courts of Maryland and Virginia is fictional. The purported conflict would come into play *only* if the tax had been declared lawful, thus forcing Virginia and Maryland individuals who paid the tax to apply to their respective states for a tax credit.

In sum, certiorari review is inappropriate because the case is free from "egregious error" under *Pernell* and *Whalen*, and the impact of the decision is limited solely to the District of Columbia without any national or federal implications.

[17] *General Motors Corp.* v. *District of Columbia*, 380 U.S. 553, 556 (1956).

CONCLUSION

For these reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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